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NOTES

FEDERAL RESERVE CHECK CLEARINGS AND COLLECTIONS

Check clearings and collections by federal reserve banks are about to become general, under the terms of an important circular issued May 1 by the Federal Reserve Board. The *Journal of Political Economy*, in April, 1915, published a general outline of a voluntary reciprocal plan of clearings on a basis of immediate credit and debit, which was adopted by all the federal reserve banks except those at Kansas City and San Francisco, the Kansas City bank continuing to operate under a plan of immediate credit and debit, with all member banks in its district included, and the San Francisco bank undertaking to inaugurate a voluntary reciprocal deferred credit and debit plan. Operations extending over almost a year have proved the voluntary reciprocal plan impracticable, because of the reluctance of member banks to enter a system of collections through which only a relatively small proportion of their items could be handled, and action looking to the broadening of the check-collection activities of the federal reserve banks has become manifestly necessary. This is the more true for the reason that on May 16 the third instalment of reserve deposits was turned over to the federal reserve banks by the member banks, thus reducing balances carried with correspondents which have served as compensation to the latter for acting as check-collection agencies, and pointing to the time, not far distant, when only money in vault or on deposit with a federal reserve bank may be counted by member banks as legal reserve.

The plan, which the Federal Reserve Board announced would be placed in operation about June 15, and has since deferred to July 15, was adopted under the power conferred by section 16 of the Federal Reserve act to require each federal reserve bank to exercise the function of a clearing-house for its member banks. The plan is not mandatory or compulsory upon the member banks, and any member bank may use or not use, as it wishes, the facilities to be offered by the federal reserve banks in the way of check collections. It does, however, contemplate furnishing, to member banks which desire the privilege, collection facilities at least equal to those furnished by correspondent banks.

Procedure under the plan will be very similar to that at present followed by commercial banks in large cities. Each federal reserve bank will receive at par from member banks checks drawn on all member

banks in the same or other federal reserve districts, and also checks drawn on non-member banks, although at the beginning checks drawn on non-member banks will be received only when they can be collected by the federal reserve banks at par. Similarly, each federal reserve bank will receive from other federal reserve banks checks drawn on banks in its district. The federal reserve banks will give immediate credit upon receipt of items, but, as is the practice in most of the large check-collecting banks of our cities, they will not consider the proceeds available to be checked against until collected. The checks will be forwarded direct to the member banks upon which they are drawn or, in the case of checks on non-member banks, to banks through which they can be collected at par, but the member banks' accounts will not be charged until sufficient time has elapsed for advice of payment to be received. In payment for items received from its federal reserve bank, a member bank may either authorize the federal reserve bank to charge the full amount of the items to its account, or may ship lawful money or federal reserve notes to the federal reserve bank at the expense of the latter.

A very important underlying principle is definitely dealt with in the circular by the Federal Reserve Board, which, in establishing the rule "that 'uncollected funds' in the hands of a reserve bank cannot lawfully be counted as reserve either by the member bank or by the reserve bank," has, while opening the way to clearing operations by federal reserve banks on a large scale, safeguarded banking reserves from impairment in the process. A member bank which draws against uncollected funds with the federal reserve bank will be charged as for an impairment of reserve, the extent of such impairment to be determined by analysis of the member bank's account.

Important economies are expected to be effected in the total cost of check collection, through having checks reach the paying banks by a reasonably direct route and after having passed through relatively few banks; but it is not suggested that checks can be collected entirely without cost. The actual cost to the federal reserve banks of collecting items will be determined by each federal reserve bank, and member banks will be assessed a fixed amount per item.

A most noteworthy feature of the Federal Reserve Board's plan is the absence of an element of compulsion, which many observers have believed would have to be exercised to make the check-collection system of vital importance. The collection system is to be built up by using the exceptional facilities which the federal reserve banks have at their disposal, to give to member banks a service as good as and better than can be had elsewhere. It is true that the federal reserve banks will expect member

banks either to remit at par for items sent them or to ship currency at the expense of the federal reserve bank, but this is a step which any bank may take, and which many country clearing-houses have actually taken, in order to secure remittances at reasonable rates. By its ruling that uncollected funds may not count as reserve, the Board appears to have avoided the danger of fictitious reserve, which has of late been an increasingly prominent and unsound characteristic of check-collection.

One very important consideration in connection with the general question of federal reserve bank operations, and one which has been much neglected by those who have written or spoken on the subject, is the strengthening of the bonds uniting the federal reserve banks and their members which will be brought about by active and successful clearing operations. Until now, in most of the districts, almost the only member banks which have had direct communication with the reserve banks have been those having occasion to rediscount paper, and the majority of member banks seem to have looked upon the federal reserve banks as emergency institutions. The Federal Reserve Board's action in designating the federal reserve banks to act as clearing-houses for their own member banks at once establishes a new and important relationship. Not only will the federal reserve banks be in a position to render services to their members which only the largest banks in a few of our large cities have heretofore been able to render, but it appears probable that the services will be rendered at a lower cost than ever before. In order to offset items coming against it, each member bank will no doubt find it advantageous to send items to its federal reserve bank, and, when the tide of exchange is flowing against it, will be glad to increase or maintain its balances with the federal reserve bank by discounting short-time paper.

With the intimate relations thus established, and if, as it is fair to assume will be the case, the officers of the reserve banks treat their members with the same courtesy and consideration that is manifested by the officers of large city banks in their relations with customer banks, there can be no doubt that the effectiveness of the federal reserve system will be much increased. With the clearing plan in full operation, less will be heard of the federal reserve banks acting merely as emergency institutions or serving as a costly means of insurance against infrequent and abnormal panic conditions. It will then be appreciated that these banks exist and are operated to render valuable service to their members and to the commerce and industry of the country in the every day operations of banking.

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